# Catalyst or Crutch?
# The Role of Privatized Land
# in Russian Enterprise Restructuring

by

Cory R. Fellows

B.A., Political Science and Russian Studies
Colgate University, 1994

SUBMITTED TO THE DEPARTMENT OF URBAN STUDIES AND PLANNING IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER IN CITY PLANNING
AT THE
MASSACHUSETTS INSTITUTE OF TECHNOLOGY

JUNE 1999



Author ______________________________________
Department of Urban Studies and Planning
May 18, 1999

Certified by ______________________________________
Lecturer Meenu Tewari
Department of Urban Studies and Planning
Thesis Supervisor

Accepted by ______________________________________
Associate Professor Paul Smoke
Chair, MCP Committee
Department of Urban Studies and Planning

# Catalyst or Crutch?
# The Role of Privatized Land in Russian Enterprise Restructuring

Cory R. Fellows

Submitted to the Department of Urban Studies and Planning on May 18, 1999 in Partial Fulfillment of the Requirements for the Degree of Master in City Planning


## ABSTRACT

The privatization of enterprise land in Russia has been viewed by many academic and multilateral experts as a key component of restructuring efforts aimed at improving the financial health and efficiency of Russian firms. Advisors who formulated and implemented the programs intended to facilitate this process predicted that landowning enterprises would shield themselves from the uncertainties associated with leasing land from the state, would be better able to attract private capital and secure bank financing, and would be able to raise extra revenue through the sale and leasing of excess land. Any secondary disposition of land, it was generally believed, could help stimulate nascent real estate markets and lead to more efficient land use patterns.

My research, the centerpiece of which was field work in St. Petersburg, Russia, suggests that the consensus expectations have been only partially realized. Firms that have purchased their land feel more secure, but on the whole they have been unable to use their land to attract equity and debt. Far more successful have been efforts to raise revenue through land leasing and sales. Overall, enterprise handling of recently-privatized land appears to have been oriented toward immediate survival needs.


Thesis Supervisor: Meenu Tewari
Title: Lecturer

Departmental Reader: Paul Smoke
Title: Associate Professor

Outside Reader: Omar Razzaz
Title: Project Manager, The World Bank

# ACKNOWLEDGEMENTS

This thesis would not have been possible without the help of many people, both within and outside the walls of MIT. In the Department of Urban Studies and Planning, I would first like to extend my deepest gratitude to Meenu Tewari. As the head of my committee, she helped me to turn my intuition and curiosity into concrete research questions during the proposal process and to glean conclusions from the clues I gathered in the field. Reader Paul Smoke brought a valuable fresh perspective, and provided excellent suggestions on how to organize and present the findings and arguments uncovered through my research. At TheWorld Bank, mentor and reader Omar Razzaz proved to be both a champion and a demanding but constructive critic. I am indebted to him for his intellectual generosity and personal guidance.

My field work was done both for this thesis and for a report for the Bank's Europe and Central Asia Department, and I would like to thank ECA Project Manager Felix Jakob for covering the costs of my trip out of his budget. In St. Petersburg, I am deeply grateful to Leonid Limonov, Tatyana Vlasova, Anna Katkhanova, and Lev Savulkin at the Leontief Centre – without whom I likely would not have been able to access the enterprise managers I interviewed. Anna and Lev continued to aid my cause long after I left Russia, answering follow-up questions and uncovering additional information. Masha Katkhanova's translation skills and familiarity with enterprises were invaluable, allowing me to pick up on subtle but important nuances during the interviews. Special thanks are due Hank Henward and Slava Miagkov in PADCO's St. Petersburg office, who provided extensive substantive and logistical assistance during my stay there. I would also like to thank Georges Korsun, Larry Patterson, Bill Valletta, and Steve Dixon for sharing expertise, documents, and methodological suggestions.

And last but certainly not least, I must thank my family and Katie for their support throughout the thesis process. I truly could not have made it through the long hours of reading, writing and re-writing – and the short days and long nights of mid-winter in St. Petersburg – without the knowledge that they were with me in spirit.

# TABLE OF CONTENTS

# Chapter 1
# Enterprise Restructuring in Russia

## Introduction

The land beneath enterprises constitutes one of the thorniest aspects of Russian enterprise restructuring; it comprises anywhere from 25 percent to 100 percent of Russian enterprise assets[1]. What enterprises can do with that land – which depends largely on what legal rights they have, and on whether or not they consider those rights to be secure – is crucial to their success in making their operations more efficient and competitive in the post-privatization era. Much of the thinking that has gone into Russian enterprise land policy has been predicated on the notion that, if businesses are given full and secure ownership rights to land, they will change the ways in which they utilize and/or leverage their land. Many scholars and advisors have argued that these changes will result in restructured enterprises that are more viable in a market-oriented setting. Another benefit of enterprise land privatization predicted in the literature and among multilateral advisors has been that the selling or leasing of excess land by enterprises will help spur the development of real estate markets by freeing up land that has not been used at optimal efficiency by formerly state-run firms. These theorized expectations – and the extent to which they have been realized thus far in Russia – comprise the main pieces to the puzzle examined in this paper.

This thesis is an attempt to both understand and contribute to the growing

[1] Omar Razzaz of the World Bank's Private Sector Development Department cited this estimate. Land can account for all of an enterprise's value when the other items on its balance sheet – including buildings, machinery, inventory, and financial liabilities – have a negative aggregate value.

discourse surrounding the role of privatized enterprise land in restructuring and the development of fledgling land markets. I first examine the evolving consensus on how the ownership structures of privatized Russian enterprises can be reformed so that it is in the interests of those in control of firm assets to make efficiency- and profit-maximizing decisions. This section also traces the motivations for enterprise land buy-outs, revealing that enterprise land privatization has been viewed by analysts and reformers alike as an important building block for successful firm restructuring and the creation of real property markets. The second chapter reviews the status of Russia's enterprise land privatization campaigns, and examines recently-reported evidence that actual practice has diverged from these expectations. I introduce three broad themes: land ownership as a bid to solidify management's control over their firms; the use revenue from land sales and leasing to meet immediate needs; and the possible positive externalities associated with the liberation of land stocks long locked away. The third chapter goes a step beyond this literature in distilling and exploring similar themes from three short case studies of Russian firms' experiences with land privatization and disposition.

In my concluding chapter I argue that, much as the privatization of Russian enterprises earlier in this decade did not lead automatically to dramatic gains in efficiency among most firms, the granting of land ownership to some enterprises has not led to some of the results predicted by reform architects. I will argue that a much more tenuous – though not necessarily less important – series of changes have taken place among many firms that have bought their land. Rather than utilizing this land to attract private capital and leverage bank financing, some enterprises are focusing on what the literature had characterized as a benefit of secondary importance: the raising of badly-needed cash through the sale and leasing of land. It is my position that this phenomenon, while a departure from textbook theories concerning the use of privatized land in enterprise restructuring, is represents a perfectly legitimate risk-mitigating mechanism that is particularly useful during times of great uncertainty and volatility. Finally, I suggest future research that could be conducted to test these conclusions and explore in detail some of the ancillary issues that arose during my investigation.

**Aligning Control with Efficiency**

Before examining the role of land privatization in the enterprise restructuring effort, it will be helpful to briefly review the theoretical discourse and sequence of events that have shaped restructuring initiatives. Having done this, it will be easier to determine precisely how enterprise land fits into the restructuring rubric.

Since the early 1990s, there has been broad agreement among reformers that enterprises in Russia and other countries formerly under communist control must restructure if those countries are to make complete and successful transitions to market-oriented economies. As a World Bank report (1997) asserts: "One of the most important tasks in the transition to a market economy is the restructuring of formerly state-owned firms. This restructuring can be thought of as the initial transition from a *highly distorted* economy with many large loss-making firms to a *normal* market economy in which most firms are profitable." (Pohl, Anderson, Claessens, and Djankov, p. 1; emphasis in original) The United Nations Commission on Trade and Development (UNCTAD) web site (1999) describes enterprises as "key actors in the development process" and characterizes them as "the major driving force behind the inter-related flows of trade, investment and technology." Indeed, the Commission states, "It is on them that the strength and dynamism of the economy depends."

Maxim Boycko, Andrei Shleifer, and Robert Vishny (1997), three of the leading architects of Russia's enterprise privatization program, argue that the distortions that characterize firms controlled at least in part by the state stem from a disconnect between "control rights" and "cash flow rights" (p. 22). They describe control rights as the rights to decide how assets are used, and cash flow rights as the rights to reap the benefits and pay the costs associated with a particular use of an asset. It should come as no surprise, they state, that gross inefficiencies result from enterprise management scenarios in which the responsibilities and benefits associated with firms are not directly linked. According to this view, a manager who has no personal economic interest in the performance of a firm is unlikely to make decisions that are most in its interest. Instead, these decisions (or non-decisions) tend to be motivated by political objectives with little or no grounding in market realities.

During the late 1980s, reforms intended to make Russian enterprises more efficient and competitive placed most cash flow rights in the hands of the public; shares of ownership, and the attendant potential for dividends, were allocated to individual citizens. Control rights, however, remained divided between firm managers and government officials. Boycko, et al (1997) argue that attempts by the faltering Soviet regime to spur enterprise restructuring failed because of this persistent split, and claim that ownership is not efficient unless control rights and cash flow rights over an asset are both held by a decision maker whose interests lie in efficiency. They advocate the concentration of control rights and cash flow rights in the hands of managers and strategic investors, but stress that changing ownership structure is not an end in itself but a means; the real goal is the efficient performance of firms, which will only result from a dramatic restructuring of all aspects of enterprise operations. This challenge is especially daunting in Russia because its mass enterprise privatization left most firms in the hands of the same managers who had run them for the state during the Soviet era.

Jeffrey Sachs (1993) echoes many of the same themes in conducting his own post-mortem on Soviet attempts at enterprise reform. He points out that, despite the fact that state-run enterprises were permitted greater leeway under the reforms to establish wages, inputs, and outputs, other fundamental aspects of the sector were left in place: prices were still controlled by the government, new firm entry into markets remained extremely difficult, and international trade was highly restricted. "In short," Sachs observes, "existing state enterprises were never put to the market test, despite being given more freedom to maneuver." He further notes that communist reformers had no desire to privatize industry or to address the "enormous inefficiencies that come from the lack of proper ownership of the enterprises" (p. 29).

While there has not always been agreement in the restructuring literature on the precisely what this "market test" should look like, a consensus around the need for it has evolved among analysts and multilateral advisors. Kaser (1995) portrays a "vicious spiral" in the former Soviet states, and argues that "the longer that adaptation of ... the capital stock is delayed, the more unstable their economies are likely to be" (p. 181). Boycko, et al (1997) argue that the "speed and scope of restructuring will ultimately determine the success of privatization" (p. 125). They assert that the depoliticization of privatized Russian firms must be accelerated if restructuring is to be successful. Such a depoliticization means more, these analysts say, than merely removing politicians and bureaucrats from direct management roles. It requires what they term "corporatization" (p. 50): the allocation to managers of the control rights that have traditionally been held by government officials. Among the most important sets of control rights are those over enterprise land.

## The Role of Enterprise Land: Academic and Multilateral Consensus

### *Tapping Into a Valuable Asset*

Since it first became clear that the days of complete state control over enterprises were numbered, reformers and scholars have recognized that the land beneath firms could play an important role in enterprise restructuring. Boycko, et al (1997) point to two ways in which they say this is true. The first, they assert, stems from the fact that when Russian firms were privatized, the land beneath them was not. This has led, they argue, to inefficient operations at many enterprises, because land is often complementary to buildings and equipment in the production process. Until both land and buildings are held privately, "control rights over complementary assets are split between local politicians and managers, which leads to a clearly inefficient ownership structure" (p. 136). The notion of enabling enterprise managers to have complete control over both plant and land is consistent with Boycko, et al's conception of the "corporatization" that they argue must take place before privatized Russian enterprises can be run efficiently. The theme of bringing complementary assets under the control of one management body will be revisited in my case studies, in which managers interviewed reference their desires to create "unified property compounds." The second benefit Boycko, et al see in enterprise land privatization is that it can provide firms with significant amounts of capital for restructuring. They state that firms often have surplus land they can sell, and that in many cases land is an enterprise's most valuable asset – and it can be used to lure more capital than is usually available through other means. They also claim that the land of Russian enterprises can be used as collateral for loans.

Many of the same predicted or assumed benefits of enterprise land privatization have been put forth by the multilateral agencies and contractors tasked with helping to lead Russia from a command-and-control to a market-oriented economy. Officials from the Russian federal agencies charged with implementing market reforms, in conjunction with American consultants funded by the United States Agency for International Development (USAID), have helped since 1994 to facilitate the privatization of enterprise land. They have done so in the belief that allowing businesses to become landowners would lead enterprises to use their land more efficiently, attract equity and debt financing, and, eventually, contribute to the development of secondary land markets in Russia through the sale or leasing of underutilized land. Reformers in Russia and their counterparts at USAID have generally viewed all of these developments as essential to the vitality of any nascent market economy. In fact, these expected/hoped-for benefits of enterprise land ownership have constituted a veritable mantra repeated often in project planning documents and meetings with business managers and government officials[2]. A recent conversation with one consultant who works frequently on USAID-funded projects, however, revealed that this consensus has become quite fragile during the last

[2] These statements are based on personal experience. I worked for one of the USAID contractors that spearheaded the first round of enterprise land privatization between 1994 and 1997.

two years; officials within the Agency, he said, have begun to openly question and debate some of these claims.

One particularly illustrative manifestation of the official multilateral consensus to date is *A Guide to Enterprise Land Sales in Russia* (1995), which was published by the United States Agency for International Development as a "how-to" manual for government administrators and enterprise managers. This publication lists the advantages to enterprises of purchasing the land they have been leasing from city and regional governments. It explains that privately-owned land is a potentially valuable asset – "one of the most valuable potential assets on enterprise balance sheets" (p. 3). The manual asserts that the enterprise land being privatized in Russia can be used as collateral for loans, can help attract outside investors who are generally wary of contributing capital to firms vulnerable to sudden changes in land lease terms, and can be sold or leased in order to aid in the consolidation of operations or to raise cash. The manual also claims that, by purchasing land, enterprises protect themselves from the risk of facing increased land lease rates.

### *Liberating a Resource Stock*

Among the chief positive externalities that many of the same analysts and advisors posit is associated with enterprise land privatization is the development of land and real estate markets. Bertaud and Renaud (1994) assert that high transaction costs associated with incomplete and uncertain land rights effectively freeze developing land markets. "If the objective is to improve land use efficiency as rapidly as possible," they argue, "one approach … is to grant existing enterprises explicit property rights in the land they now occupy" (p. 16). They predict that, given these more clearly elaborated rights, enterprises will have the incentive to use that land at optimal efficiency – or transfer it to other users who can.

This is not a unanimous view, however. In 1990, for instance, a group of American economists led by Nicolaus Tideman wrote an open letter to Soviet President Mikhail Gorbachev warning him that, although his country's anticipated movement toward a market-oriented economy would bring increased prosperity to its citizens, he should not allow land to be fully privatized. Businesses and other improvements on the land should be freely owned and transferred, the authors asserted, but local governments should retain ownership of the land itself. Under such a system, the users of land would pay the state regular rents. The rationale behind this regime was three-fold. It would guarantee that "no one dispossesses fellow citizens by obtaining a disproportionate share of what nature provides for humanity," provide revenues with which governments could provide infrastructure and social services, and permit "utilities and other services that have marked economies of scale or density to be priced at levels conducive to their efficient use."

It is the view expressed by Bertaud and Renaud, however, which has held sway among the government officials and multilateral advisors most involved in Russian market reforms. And, as with the related literature on enterprise restructuring, the consensus among those primarily concerned with the development of efficient land markets has been that this should be done posthaste; transactions will not occur, holds this prevailing school of thought, unless/until land rights are expanded and better-guaranteed. On the basis of such reasoning, it would appear to be in the interests of both the enterprise sector and nascent land markets to privatize as much enterprise land as quickly as possible. This was the conclusion at which Russian reformers and their multilateral counterparts arrived during the early 1990s.

# Chapter 2
# Enterprise Land Privatization

## Legal Authority

During the 75 years of Communist rule, all property in Russia was state-owned. While most property – including enterprises – was quickly privatized following the collapse of the Soviet Union, the land beneath those enterprises remained in government hands. Although the Russian Federation's 1993 constitution states that "land and other natural resources may be in private, state, and other forms of ownership," federal lawmakers have been unable to formulate a legal system that would clearly define and protect private rights in land (Brooks, Krylatykh, Lerman, Petrikov, and Uzun, 1996). The creation of such a legal framework has been among the chief tasks of reform efforts since Russia embarked on its fitful transition from a centrally-planned to a market-oriented economy (Kaganova, O'Leary, and Vysokovsky, 1997).

In the absence of such a framework, reformers have acted under presidential decrees and contested local laws to privatize pockets of land in selected cities and towns. Enterprise land privatization efforts began in late 1994 in accordance with Presidential Decree No. 15-35, which stated that Russian businesses could become owners of the land they occupied by purchasing it from the government. Since the issuance of this decree, enterprises in several *oblasts* (roughly, provinces) across Russia have taken advantage of the opportunity to obtain title to the land underneath their buildings.

## The Early Numbers

According to an August 1997 report submitted to USAID by Chemonics, Inc., a private consulting firm which spearheaded a donor-funded effort to assist both businesses and local governments with the enterprise land privatization process, the company facilitated 961 such transactions in 36 Russian oblasts between mid-1995 and mid-1996. The report also claimed that another 1,345 transactions were "in the pipeline" at the end of 1996 (Chemonics, Inc., 1997). It is unclear how many enterprises have purchased their land independently or since the conclusion of the USAID-sponsored program. A USAID-commissioned document (Brzeski and Valletta, 1997), however, reported that, since the end of the donor-aided program, 2,927 parcels of industrial and trade enterprise land – totaling 14,600 hectares – had been privatized. While the report points out that this is an extremely small percentage of the 3 million hectares designated for industrial use, it states that "in a few cities a substantial portion of the industrial land became privatized" (p. 17). The top performer in this regard was the City of St. Petersburg, where over 2,000 parcels of enterprise land had been privatized as of mid-1997. St. Petersburg will be the setting for the industrial enterprise case studies to be discussed later in this paper.

**What Was to Be Done? Initial Reports on Aims and Achievements**

What types of enterprises have sought to purchase their land, and what have their objectives been? A 1997 report by the Leontief Centre for Social and Economic Research, which was based on detailed surveys of over 100 enterprises in several regions in 1995 and 1996, revealed that enterprises involved in a wide array of activities – including forestry, oil extraction, heavy and light industry, retail, and service-based businesses – entered into the land buy-out process between 1994 and 1996. Table 1 provides a breakdown of the types of businesses most active in land privatization, along with the number and cumulative land area of transactions, for a few selected cities and regions as of 1995.

In a published narrative commenting on the findings of the Leontief Centre study (1995), Leontief Director Leonid Limonov stresses that it was the financial condition of the enterprises that played the single biggest role in determining which ones pursued ownership of the land they occupy. He asserts that enterprise land privatization has been seen primarily as a means for relatively healthy businesses to improve their outlook – not as a source of salvation for failing enterprises.

**Table 1: Enterprise Land Sales Data for 7 Russian Regions, November 1994**

| **Region (*oblast* or city)** | **Enterprises that Had Bought Their Land** | **Enterprises Still in the Buy-Out Process** | **Total Area of Purchased Land (hectares)** | **Leading Purchasing Industries** |
|---|---|---|---|---|
| Archangel *Obl.* | 11 | NA | 97 | Mineral Processing |
| Chelyabinsk *Obl.* | 7 | 9 | 10.54 | Retail, Construction, & Transport |
| Kostroma *Obl.* | 3 | 1 | 11.8 | Science & Engineering |
| Krasnodar Terr. | 158 | 798 | 1011 | Food, Construction, & Industry |
| Kurgan *Obl.* | 27 | 12 | 14.2 | Retail & Public Catering Services |
| St. Petersburg | 51 | 682 | 63 | Retail, Services, & Food |
| Saratov *Obl.* | 194 | 105 | 422 | Agro-Industrial & Construction |

*Source: Leontief Centre*

According to the Leontief Centre's surveys, the main overriding goal for the majority of Russian enterprises seeking to buy their land between 1994 and 1996 was to create what the Centre terms "unified property compounds." Such "compounds," the Centre asserts, are viewed by many enterprises as necessary if they are to "reap the benefits of all the major rights and advantages that come with land ownership" (p. 2). While the Leontief report does not elaborate on precisely what is meant by a "unified property compound," it goes on to list the attraction of investment and the expansion/improvement of production capabilities as the top two specific objectives given by Russian enterprises as motives for entering into the land buy-out process. Limonov (1995) states that, in most cases, "the main motivation for buying out a site is an investment project that, under a condition stipulated by the investor, cannot be realised until the site is privatised" (p. 81). Other goals that appeared with less frequency in responses to the Leontief surveys were: mortgaging the site; leasing out the site; and changing the type of land use. The Centre's report notes that the motive that declined most in frequency from the 1995 to the 1996 questionnaire was the hope of mortgaging sites. The report speculates that this was due to heightened pessimism about the legal framework (or lack thereof) for mortgage-based financing in Russia and about general reluctance on the part of banks to engage in long-term lending.

**Table 2: Primary Enterprise Motives for Land Purchases, 1995 & 1996 (as percentage of all enterprise responses)**

| Motive | 1995 | 1996 |
|---|---|---|
| Form Unified Property Compound | 57% | 78% |
| Attract Capital from Outside Investors | 44% | 23% |
| Expand/Update Production Capacity | 30% | 25% |
| Mortgage the Site | 20% | 7% |
| Lease Out the Site | 11% | 7% |
| Sell the Site | 9% | 6% |

*Source: Leontief Centre*

Only about 50 percent of respondents to the Leontief Centre's 1996 survey said they had actually benefited economically from the purchase of their land. The least successful enterprises of those questioned by the Centre were those that had identified their primary land-privatization goal as "attracting investment"; only five percent of these respondents reported actually attaining this goal. More successful were plans to sell land; 50 percent of those listing the re-sale of their sites as the primary goal did in fact do so. The next most successful were plans to expand and/or modernize production capabilities and to lease out purchased sites; roughly one-third of respondents reported that these objectives had been met. Of the small number of enterprises that sought primarily to mortgage their land, only 20 percent said they had actually been able to do so. The main reasons given by enterprises for these low levels of implementation were: difficulties in attracting investor resources; the absence of a full-fledged secondary land market; unstable enterprise finances; and the extensive amount of time often required to carry through changes in production.

**Table 3: Realization of Primary Enterprise Motives for Land Purchases*, 1996 (as percentage of all enterprise responses)**

| Objective | Approximate Success Rate |
|---|---|
| Attract Capital from Outside Investors | 5% |
| Expand/Modernize Production Capacity | 33% |
| Mortgage the Site | 20% |
| Lease Out the Site | 33% |
| Sell the Site | 50% |

*Source: Leontief Centre*

*The survey did not ask enterprises to report whether they had been able to create unified property compounds through the purchase of their land.

A recently-published study by Howland and Katkhanova (1998) examines the disposition of land by industrial enterprises in the St. Petersburg area. Their survey results appear to reinforce one of the Leontief report's key findings vis-à-vis enterprise land privatization motives: that the single most common incentive has been the ability to facilitate the improvement, expansion, or revamping of production capabilities. The report asserts that industrial enterprises in St. Petersburg are attempting to use land ownership "to raise needed revenue, particularly through the sales or lease of excess property." These income sources, it continues, "sustain enterprises as they modernize their plant and equipment, refine their products to become competitive in the national and international economy, and find new markets" (p. 19). Some of the enterprises surveyed reported garnering most or all of their income from land sales and leasing – including a military hardware design company that kept 100 design workers on the payroll with the professed expectation that the firm would eventually return to its traditional line of business (Howland and Katkhanova, 1998).

**Some Emerging Themes**

From these early reports on the outcomes of enterprise land buy-outs, it is apparent that firm handling of privatized land has not conformed completely with textbook predictions. In addition to attempting to use this land to improve the efficiency of their traditional operations, attract investment, and leverage bank financing, many enterprises are utilizing parcels to meet more immediate ends. In this vein, three main themes can be extracted from the studies just reviewed.

The first theme is centered around control and security, and is captured in the notion of the "unified property compound." As theorized in the literature, Russian enterprises do seem to be using land as a key component of their corporatization efforts; the unified property compound would appear to be a manifestation of these firm managers' desire to extend their control over all of their complementary assets. Judging from the responses generated by the Leontief and Howland surveys, some enterprises clearly do expect to enhance their abilities to control their businesses by purchasing the land they occupy. And they at least profess to intend to use this heightened sense of security in making fundamental changes to their production processes – changes they say will enable them to become more efficient and competitive. This will be possible, these managers seem to have believed, because their new status as landowners would attract much-needed capital for restructuring from strategic investors and/or lending institutions.

The second theme to emerge is that many enterprises have in actuality utilized their newly-purchased land to diversify and hedge against risk in a highly uncertain economic and political climate. Both the Leontief and Howland reports highlight the stated desire of managers to leverage their land in attracting capital and revamping their operations. But the Leontief findings show that these objectives have rarely been achieved, and both studies illustrate the growing reliance of firms on more short-term benefits of land ownership. Revenue from secondary land sales and leasing has become an important source of capital for a number of enterprises. The managers of these firms have generally insisted that these funds are being used to stave off bankruptcy only until they can once again rely on their traditional core activities. Regardless of whether or not this diversification proves to be truly temporary, it represents an important risk-mitigating tool for struggling enterprises. To the extent that these businesses come to rely exclusively on short-term land-generated revenues for their survival, this practice poses a perplexing question for enterprise reformers: Is this an undesirable stalling tactic that needlessly prolongs restructuring, or a useful transitional mechanism that enables restructuring to occur within a volatile context in the first place?

The third theme that can be discerned, both explicitly and through inference, is that the sale and leasing of land by Russian enterprises appears to be contributing to the development of nascent secondary land and real estate markets. Real property that has long been locked away is being released, and firms with excess land on their hands are finding that there is a demand on the part of other businesses in some areas for space. One important implication of this may be that, as secondary land markets thus develop, the option of selling or leasing parcels of land might become more attractive to enterprises with excess land. This could lead to more efficient land use overall, as struggling enterprises realize that it is uneconomical to hold on to underutilized land and sell or lease it to firms that can put it to immediate productive use. There may also be broad economic benefits to cities and regions where such activity accelerates, as demand grows for trained specialists in such areas as appraisal, brokerage, and legal services.

It must be emphasized that these findings are preliminary; enterprises have only had the opportunity to purchase the land they occupy since late 1994, after all. Furthermore, they are based on closed-ended surveys and questionnaires that do not allow for extemporaneous elaboration or the interpretation of the nuances that might accompany responses to more open-ended questions. In an effort to further explore these themes while partially addressing the latter methodological constraint, I conducted three short case studies of industrial enterprises in St. Petersburg during January and February of 1999. The results of this field research will be presented in the next section.

# Chapter 3
# Three St. Petersburg Case Studies

As I discussed in the preceding section, the Leontief and Howland studies yielded intriguing data on the planned and actual disposition of land by Russian enterprises. Among the most interesting of these researchers' conclusions were the stated desire among many firms to create "unified property compounds" through the purchase of their land and that many industrial enterprises are using their land to generate much-needed revenues as they explore expansion and retooling options. These findings suggest that Russian enterprise managers, rather than following to the letter the prescriptions of restructuring scholars and advisors, are using their land to buy themselves flexibility and time as they endeavor piece-meal to adapt to new and challenging realities.

In order to further explore these themes, I conducted condensed case studies of three industrial enterprises in St. Petersburg, Russia during the winter of 1999. Each of the enterprises visited shared certain key characteristics: a traditional focus on large-scale manufacturing; firm privatization during the early 1990s, which retained most pre-privatization managers; the purchase from the city government during the past five years of land occupied by the enterprise; significant reductions in production activities and labor forces since the early 1990s; and a growing reliance upon the sale and leasing of land and fixed assets as a revenue source. These case studies, while not meant to reveal statistically significant trends or to relate complete snapshots of particular enterprises, provided an opportunity to probe more deeply than previous investigations through relatively open-ended conversations with managers about their objectives and actions.

## The Firms: DSK-4, LOMO, and Kirovsky Zavod

### *DSK-4*

DSK-4 – which stands for "Domostroyitelny Kombinat 4" or "Residential Construction Plant Number 4" – was a high-volume, state-run manufacturer of prefabricated residential buildings during the Soviet era. Its business evaporated in 1993, however, with the disbanding of the City agency that had been its primary client and the lack of any other demand for the enterprise's products. The firm was privatized that same year, and attempted to find a foreign partner to help upgrade and overhaul its production process with new equipment and expertise. The search for such a partner failed, and construction activity ceased entirely in 1996.

The enterprise then decided to capitalize on what it did have: land. In 1995, DSK-4 had been among the first St. Petersburg enterprises to buy the land beneath one of its sites; 14 hectares were purchased. In 1996, the firm bought another 22.6 hectares. It sold or leased most of the land it had bought in 1995, holding on to only 12 hectares. This remaining land is "at the firm's disposal" for possible future "productive" (preferably construction-related) use. Of the 1,450 employees on the payroll before the halting of construction activities, 600 were reassigned to a newly-created subsidiary that specializes in such small-scale construction as interior decorating and roof work; the rest were terminated. I interviewed Valery Burakov, the firm's Deputy General Director.

### *LOMO*

LOMO is a huge and highly diversified company. Its core business, as during the Soviet period, is the manufacture of optical equipment. But, as also under Communism, the giant company has its hands in many other activities as well – including raw materials processing, stores and services used by its employees, and even agriculture. According to

St. Petersburg real estate expert Miagkov, the privatized LOMO has carried forward the Soviet tradition of attempting to provide for all of the needs of its production and employees on its own. LOMO Real Estate Department Director Marina Zvereva said that before it was privatized in 1993, LOMO employed 20,000 employees, 700 buildings, and more than 15,000 units of production-related equipment – all scattered across approximately 1,000 hectares of land in and near St. Petersburg.

According to Zvereva, LOMO became the first St. Petersburg enterprise to buy a portion of its land when it entered into the process of making its first purchase in 1994. LOMO was among the first St. Petersburg enterprises to create a department devoted exclusively to property management activities; Zvereva is its first director. That first buy-out was of land located beneath industrial objects. All told, Zvereva said, the firm has spent 3.9 million rubles to purchase 28 hectares of land. The most active year for land buy-outs was 1997 – a year that saw many investors becoming more optimistic about the Russia's prospects in the wake of Boris Yeltsin's defeat of a Communist challenger in the 1996 presidential election.

***Kirovsky Zavod***

Kirovsky Zavod, which translates literally as "Kirov Plant," has long been an important manufacturer of heavy equipment. The firm's products have ranged from bulldozers to tanks. It occupies a large site in southwestern St. Petersburg, and has its own docking facilities on the Gulf of Finland. Kirovsky Zavod completed the roughly three-year-long process of purchasing its 72 hectares of land on January 5, 1999.

I interviewed Deputy Property Foundation Director Alexei Belov and Chief Property Foundation Expert on Land and Real Estate Usage Galina Dadykina. Perhaps because of its traditional role as a key member of Russia's military-industrial compound, these managers seemed even more wary than those of other enterprises about divulging information to an outsider. But although it was not possible during my visit to obtain quantitative information regarding land purchases and the overall makeup and direction of the firm, some of the responses I did get seemed revealing in their own way.

## Emerging Themes Revisited

My interviews with managers from these enterprises yielded insights into the three broad themes introduced in the preceding chapter: the desire of landowning firms to use their real property as a risk-mitigating instrument, the growing reliance of some firms on the short-term returns generated by land sales and leasing, and the sense that many of these enterprises are helping to create secondary land markets which in turn make land sales and leasing more attractive to struggling enterprises. In the following sections, I will examine these themes in more detail by drawing upon my case studies.

### *Buying (and Negotiating) Security*

All of the managers I interviewed claimed that they do feel more secure since buying their land. While each emphasized a different aspect of security, ranging from freedom from some government requirements to the often-vague notion of increased overall control through the creation of unified property compounds, the desire to minimize risk through land ownership was shared by all. When asked how secure he felt DSK-4's land ownership rights were, given the fact that no land code is in place and that there remains a great deal of political and economic uncertainty, Burakov replied that he was quite confident. He said that the title registration process was completed with reasonable speed, and that managers came out of it feeling that they were "true owners" of their land. Burakov said that he thought it would be possible for DSK-4 to use its land as collateral for loans, and claimed that the firm was in good standing among lenders; "they know us," he said with special emphasis. It is the terms on which banks currently lend, he said, that would make borrowing difficult. Only short-term loans are being granted, and at high interest rates starting at 18 percent. In any event, Burakov claimed, his firm is presently in no need of debt.

The avoidance of lease payments – and therefore of the risk of being subject to sudden or dramatic increases in lease rates – had been among the main selling points of the enterprise land privatization program, and the company had expected to economize by buying the land it had been leasing. This hedging strategy has not paid off. Burakov said that these taxes had increased 400 percent since the company bought its land, compared with an inflation rate of 84 percent during that time[3]. The Leontief Centre's Katkhanova and St. Petersburg real estate expert Vladislav Miagkov confirmed to me that, within the past two years, the property tax rates set by the Russian central government have surpassed the lease rates set by the City of St. Petersburg. Miagkov said that this was a well-recognized issue among new commercial and industrial landowners throughout the St. Petersburg area, and that many of them feel that they were misled by the government officials and foreign advisors who assured them prior to their land buy-outs that they would eliminate some uncertainty and save money by owning rather than leasing.

LOMO's Zvereva said that the primary objective that motivated LOMO to purchase its land was that of forming a "unified property compound" in which the firm's land and buildings were all brought under the firm's control. This, it was thought, would help to mitigate risk in two important ways. First and foremost, it would enable LOMO to freely manage both the fixed assets and land that it uses. Second, it was believed, it would enable the enterprise to attract outside investment. Finally, it was thought that the firm could save money, as DSK-4 had hoped to do, by avoiding lease payments (and arbitrary increases in them) to the municipal government for the use of City-owned land.

[3] Leontief Centre researcher Lev Savulkin, who is an authority on the business climate in St. Petersburg and the rest of western Russia, confirmed that this inflation figure was correct.

The key assumption underlying this strategy was that property tax rates would continue to be lower and more predictable than lease rates.

Zvereva said that LOMO has succeeded in creating a unified property compound, but not all of the expected attendant benefits have been seen. The firm does feel that it controls all of the property it utilizes. When asked whether she feels that LOMO's land ownership rights are secure in the face of political and economic uncertainty, and given the fact that a national land code still has not been put in place, she expressed confidence. But she then quickly added, with a fatalistic shrug: "Of course, you can never be completely secure until the end."

LOMO's management may feel reasonably secure in the firms' ownership of both buildings and land, but its bids to attract investment and save money by avoiding lease payments have not panned out. Zvereva said that potential investors are reluctant to commit resources within a climate of such political and economic instability. She also complained, as DSK-4's Burakov had, about the fact that property tax rates are now higher than City lease rates. In addition to the fact that LOMO has not saved money by buying instead of leasing, the low City lease rates sometimes undercut private firms like LOMO that seek to lease out parcels of their own. Zvereva expressed hope that ongoing reform efforts would result in property tax rates that are tied more to actual and potential use than arbitrarily-defined location indexes[4].

While it was not among LOMO's primary reasons for buying land, Zvereva said that the firm had hoped that it could use land as security for bank loans. She said that this no longer appeared realistic, however. The ongoing banking crisis has led most banks to

[4] Vladislav Miagkov, the St. Petersburg real estate expert cited elsewhere in this paper, has been involved with these efforts. He showed me the cadastral maps used to help determine tax rates, and explained that these are derived from a formula that weighs such factors as distance to the city center and proximity to transportation corridors and nodes. These factors are plotted on a matrix along with designations meant to describe the nature of commercial and institutional landowners – designations, Miagkov said, that are often debatable, inaccurate, or outdated. An example of an outdated entry would be a property listed as an active industrial property that in fact contains idle machinery and is being used by lessees for warehousing. Its owner pays the higher tax rate that coincides with an active industrial site.

avoid long-term lending of any kind, and Zvereva said that much of the old industrial-grade land LOMO now owns is considered "unsuitable" collateral for banks.

In general, Zvereva said that LOMO probably did not think through all of the potential advantages and drawbacks of buying its land before diving into the process. In addition to the tax issue, she said, the firm felt stung by the realization after buying land the cadastral boundaries of some properties were not finalized by City authorities or were being contested by abutting landowners. Zvereva claimed that some of the enterprise's land became subject to evolving land use regulations, including one potentially valuable parcel that cannot be developed or leased because it has been declared a historical site. While Zvereva said that most of these issues either have or will likely be resolved to LOMO's satisfaction, she lamented both what she views as the City "changing the rules during the game" and the company's naiveté in making what proved to be incorrect assumptions about the future of government tax and land-use regulatory policies when entering into the land buyout process.

Both of the managers I interviewed stressed that Kirovsky Zavod's main reason for buying the land it occupies was that it wanted to solidify the firm's control over all of its property. By doing this, it was thought, the firm could expand and improve its productive capacity. This explanation seemed quite similar to Zvereva's reference to LOMO's desire for a "unified property compound." When pressed to explain precisely what becoming the owner of its land would enable Kirovsky to do that it could not do without it, Belov replied emphatically that "an owner is an owner;" it is obvious that any business owner, he said, wants to have complete control over all of the property used by the firm. Later, Belov and Dadykina explained another way in which they thought Kirovsky's production activities could be expanded and improved through ownership of the enterprise's land: the attraction of foreign investment. Both managers said that, while the firm might eventually look to use its land as collateral for loans, there was no intention to do so in the immediately foreseeable future. Like the other enterprise representatives interviewed, they seemed to be more optimistic about the prospects of attracting private equity with their land than bank debt.

Unlike the managers at DSK-4 and LOMO, Belov did not respond to questions about government policy by emphasizing the fact that tax rates had surpassed lease rates. Instead, he opined that government should not try to apply uniform ownership rules to all enterprises; an "individualized approach" in which public officials work on a firm-by-firm basis, he said, would be preferable. When Belov was asked how secure he felt Kirovsky's land ownership rights are he responded, not in terms of legal guarantees, but in terms of the "great faith" all managers have in the General Director's decision to authorize the purchase of the enterprise's land. This well-respected superior would not have done so, Belov said, unless he was comfortable with the terms of ownership and disposition to which the firm and the government were agreeing. The clear implications were that Kirovsky's Zavod managers viewed their General Director as a shrewd man, and that it logically followed that the enterprise's land acquisition was a good deal.

### *A New Lease on Life?*

Although DSK-4 Deputy General Manager Valeri Burakov said that one of the main incentives that initially motivated DSK-4's purchase of its land was the promise of circumventing many of the permits associated with carrying out production activities on government-owned land, none of the firm's subsequent actions were related to its traditional business; DSK-4 quickly metamorphosed into a property management firm. Burakov claims that it is now the second largest real estate-focused organization in St. Petersburg, trailing only the City Property Foundation (which administers the leasing and privatization of City-owned land). At the core of the enterprise's mini-empire is what nearly amounts to a business park. Located on what was once one of the firm's chief construction sites, this concentration of buildings hosts 22 businesses that bought land from DSK-4 and 15 that are leasing from the firm. Included among these are at least three large foreign firms, including Procter and Gamble. Tenants use the parcels for warehousing, food processing, and office space. The road that runs through the area, which was once a private DSK-4 drive, is maintained through a condominium-type system in which all of the owners and lessees located along it pay into a common fund. Burakov claimed that DSK-4 has asked the City to take possession of – and therefore responsibility for – the road, but that City officials refused. In addition to this real estate core, DSK-4 is attempting to lease out space in a large building it owns in central St. Petersburg (it does not own the land), and has hopes for a downtown business center.

According to St. Petersburg business analyst Lev Savulkin, DSK-4 followed the letter of the law when changing its business focus. It changed its charter, filed the necessary paperwork with the City government, and paid all required fees. The company is now officially registered with the government as a firm permitted to carry out real estate disposition and management activities. This is significant because, according to the Leontief Centre's Anna Katkhanova, strict government-imposed restrictions to what activities certain types of enterprises – and the expensive and time-consuming bureaucratic processes involved in legally circumventing them – make it difficult for most enterprises to formally add to or reorient their operations in this way. Katkhanova and Howland claim in their paper, in fact, that many industrial enterprises throughout the St. Petersburg region sell and lease significant amounts of land without obtaining official permission. Another course that DSK-4 could have taken is bankruptcy. According to Katkhanova and Savulkin, that process is very complicated and expensive as well. It would seem reasonable to assume that both sets of regulations discourage some enterprise managers from adopting radical new strategies or dissolving their firms entirely.

Recent real estate-related profits notwithstanding, Burakov claimed that DSK-4 would like to revive some type of construction-related activity on a portion of its remaining land. Management is wary of the fact that many of its lessees, who tend to rely heavily on imported equipment and supplies, were especially hard hit by the August 1998 financial crisis and are therefore risky tenants. Revenues from land sales and leasing have already paid off the firm's debts, and a reserve is now being built up for eventual use in revamping DSK-4's productive capacity – with the help of a much-hoped-for foreign partner. The fact that the firm owns its land, the Deputy General Manager said, will improve its chances of attracting such a partner. The implication seemed to be that, while the property management business had proved a valuable revenue-generating activity thus far, it would prefer to avoid relying on it entirely and to return at least partially to its roots.

LOMO has also been highly successful at leasing land on the burgeoning secondary market. According to Zvereva, LOMO currently has more than 140 lease agreements with other companies. She would not specify what portion of the firm's land is being leased out, but a St. Petersburg business magazine that reported on the growing tendency of area companies to raise money by purchasing and then leasing out their land placed this figure at approximately 15 percent (*Business Petersburg*, 1999). LOMO's tenants use the properties predominantly for warehousing and small-scale retail activities. The revenue generated by these leases has become increasingly important to enterprise's overall budget. Zvereva went so far as to state that LOMO's land leasing activities are essentially supporting the company during otherwise difficult times, but she insisted that the core optical business would not be abandoned.

As with many other large industrial enterprises with a traditional focus on defense-related manufacturing, the size of Kirovsky's productive business has shrunk substantially since the collapse of the Soviet Union. While output and revenue figures could not be obtained, there are clear indications that managers have moved to restructure key aspects of the enterprise's operations in the face of this challenge. Between 1992 and 1998, managers reduced the firm's workforce from 35,000 to 12,000 employees. Kirovsky has for several years supplemented its revenues by leasing a significant portion of its fixed assets, which include port facilities and heavy machinery, to other firms. Belov and Dadykina would not rule out the possibility that Kirovsky might sell or lease portions of its land now that it owns it, but they stressed that the focus would remain on the enterprise's traditional core productive activities.

# Chapter 4
# Conclusions

## Risk Management, Diversification, and Positive Externalities

The preceding handful of short case studies provides some insights into the three broad themes that emerged from the Leontief and Katkhanova studies: most enterprises that have bought their land do generally feel more secure in their control over their properties; some are coming to rely on short-term returns from land sales and leasing; and these secondary activities are releasing land parcels into an emerging real estate market. On the whole, firms have not succeeded in using their privately-held land to attract private investment or to secure bank loans. The best-laid plans for enterprise land privatization, then, have been only partially realized. The firm behavior that has resulted has been decidedly more tenuous and rooted in immediate needs than those plans anticipated. As I will argue in the following sections, this is not necessarily a bad thing.

### *Hedging Their Bets*

One of this paper's findings is that many enterprises buying their land hope to establish "unified property compounds" which they believe will enable them to attract additional capital and give them full and secure control over all aspects of their operations. All of the managers I interviewed spoke of the importance of being "true" owners. Their tones suggested they thought it should be obvious that any firm would want to have as much control as possible over the assets associated with their businesses.

This conviction was partially rooted in the fact that foreign investors usually prefer or insist that potential Russian partners own their land, and in the belief that enterprise-owned land could be used as collateral for loans once the ongoing economic crisis has passed. But there also appeared to be a more intrinsic, if not always clearly articulated, value placed in the very notion of ownership. When an enterprise owns both its buildings and its land, the managers seemed to believe, the risks associated with unpredictable government authorities can be minimized. The fact that the security of that very tenure might very well be subject to the vicissitudes of political change did not dampen this enthusiasm; at most, managers gave fatalistic shrugs and insisted that nothing could *ever* be *completely* guaranteed in their country. There seemed to be a belief on the part of some managers that this lingering uncertainty could be accounted for through individualized negotiations.

So just what is a "unified property compound" within such a setting? The answer, I believe, is encapsulated in Kirovsky Zavod manager Alexei Belov's statement: "An owner is an owner." This and some of the other explanations offered by the firm managers I interviewed seem consistent with the notion of complete control rights over complementary assets elaborated by Boycko, et al which are discussed in Chapter One. I would suggest that a unified property compound is one in which both buildings and land are controlled by private enterprise managers, thus ensuring – in the estimation of the managers, at least – that the firm's operations are run as efficiently as possible. Russian enterprises strive to attain this level of control within a highly imperfect institutional context. There is no national land code to fully guarantee private land rights, and the LOMO case demonstrates that firms are still somewhat vulnerable to unforeseen land-use planning decisions by government. Indeed, if there is one thing owners can be certain of it is uncertainty – hence the shrugs of resignation when managers are pressed to state whether they truly believe they will always have total control over their newly-purchased real property. Similarly, enterprises that seek to restructure their operations through different land disposition schemes face a daunting and expensive maze of profile restrictions and other regulations which make it difficult for them to legally reorient their businesses and provide disincentives for those that might otherwise cut their losses and shut down completely.

When Russian enterprises purchase the land they occupy from governmental authorities, they are in a sense renegotiating the terms under which they can control, use, and dispose of that land. Each such renegotiation is conducted against the backdrop of an uncertain legal environment, and despite a fundamental cynicism about the value of state guarantees. If one views these transactions in this way, it may be instructive to look to the idea of incomplete contracts elaborated by Hart and Moore (1985). Their work emphasizes the importance of uncertainty and asymmetrical information when any two parties commit themselves to a contract, and concludes that these parties explicitly or implicitly acknowledge the likelihood that certain contingencies may arise during the life of that contract. Hart and Moore assert that any assumption of "unbounded rationality" on the part of negotiating parties must be dropped; in the end, there are no true guarantees (p. 39). The enterprise managers I interviewed, for all their professed faith in their land titles, seemed to acknowledge this with their subsequent qualifications and shrugs. The Kirovsky Zavod manager's stated desire for more overt and individualized negotiations between enterprises and the government over the terms of land ownership and disposition, which would presumably be aimed at minimizing or compensating for uncertainty and asymmetrical information among the parties, is another manifestation of this notion.

***Regrouping, or Just Reaping?***

My field work also illustrates another of the findings uncovered in the Leontief and Howland/Katkhanova research into Russian enterprise land disposition. The interviews I conducted supply evidence of something Limonov, in interpreting the Leontief survey results, described as increasingly common in Russia: the actual or planned use of land by enterprises to help facilitate the expansion or reorientation of business activities. DSK-4, once an important manufacturer, now boasts of its real estate management prowess – even as it claims to remain intent on returning to some sort of industrial activity. LOMO acknowledges that land leasing revenues are supporting the company during difficult times. Kirovsky Zavod, while a newcomer to the ranks of land-owning enterprises, has increasingly relied on the leasing of its fixed assets for income and is considering doing the same with some of its land. My findings also support Howland and Katkhanova's assertion that many enterprises are using land ownership to raise badly-needed revenue that helps sustain them as they revamp their production processes or seek new markets. Just how likely it is that the firms I visited will ever realize their stated production-related objectives, of course, is open to question.

Whether the use of land to keep struggling or failing enterprises afloat is a good or bad thing is an important question. Should the raising of revenues through land sales and leasing by struggling enterprises be viewed as prolonging the inevitable by keeping non-viable enterprises alive when they should really shut down completely? Or should this practice be seen as a resourceful way for enterprises to buy needed time as they try to regroup and restructure in the face of economic crisis and insufficient/nonexistent market-supporting institutions, such as mortgage lenders?

It is useful to recall at this point the most commonly-cited problem with Russian enterprise restructuring since its inception following the mass privatization of enterprises in the early 1990s. This is the fact that Russia's mass privatization of enterprises left most firms in the hands of old-line or "insider" owners and managers who do not possess the management skills necessary to take the measures needed to make their businesses more efficient and profitable. DSK-4, LOMO, and Kirovsky Zavod are all run by the same general groups of managers who were in place prior to privatization. And, in some respects, the managers of these firms do exhibit the expected characteristics. Perhaps the best example was the claim by DSK-4 management that it had to remain alive as an entity even after its sole market vanished because it was responsible for making pension payments to former employees. The firms I interviewed, however, have all taken measures to change their operations in light of the difficult market conditions they face. All have shed significant amounts of labor, cut back on or ceased unprofitable production, sought investors to help them improve their production processes, and sought to diversify by entering or exploring entirely new markets. Privately-owned land is seen by these enterprises as an important part of these efforts, either because it generates revenue streams that keep them alive or because it is viewed as a valuable asset that can eventually attract the capital needed to regain competitiveness in traditional markets or to enter new ones.

It is important to recognize that the time horizons of most enterprise managers are, of necessity, very short; most are preoccupied with tapping into sources of cash quickly so that they can pay debts and bills, and do not have the luxury of formulating and following grand long-range plans. Whether one views this as a good or bad thing depends in large part on one's starting point. It does appear that some enterprises, their oft-stated plans for foreign partnerships and widespread restructuring notwithstanding, seem to be using land to keep themselves afloat when they would otherwise not be viable. But I would argue that it is both legitimate and desirable that Russian enterprises be able to buy themselves some time as they muddle their way through immature and volatile marketplaces, even if some have only slim hopes of actually succeeding in the long run.

As with many other aspects of Russia's path toward a market-oriented economy, the restructuring of enterprises and the reallocation of the land they occupy will be an unavoidably messy processes. An appraisal of the Russian context by Alfandari and Lee (1995) is still valid today: "The ownership changes have been very recent, the economic environment is still unstable, and the basic market institutions and infrastructure are still at an early stage of development" (p. 2). Given this reality, it is encouraging that enterprises are attempting to restructure at all. It appears that, for some firms at least, this has been possible because of the ability of managers to creatively leverage their real property assets.

Stark (1995), in writing on the adaptive measures taken by many post-socialist firms in Hungary, insists that it is neither realistic nor appropriate to demand that these newly-minted economic actors follow a prescribed straight line of reform. He characterizes the intermediate form of control over firm assets that often evolves following privatization as "recombinant property," and asserts that this is a perfectly healthy phenomenon. Stark argues:

> "Instead of building tabula rasa on the ruins of communism, we [ought to] examine how actors in particular locales and settings are rebuilding organizations and institutions within the ruins of communism. Instead of paralysis and disorientation we should expect to see actors, already accustomed to negotiating the ambiguity of contradictory social forms, adjust to new uncertainties by improvising on practiced routines. Instead of grand schemes of architecture, of social engineering, and designer capitalism we [ought to] examine transformative processes of bricolage. (p. 6; emphases in original)

Viewed in this way, the sale and leasing of land by struggling enterprises should be considered, not as a wasteful stalling tactic, but as a useful buffering mechanism that helps to protect firms and their workers from some of the shocks of rapid privatization campaigns. Not all of them will ultimately succeed, but the legacy of their efforts will be evident in the shape of future markets.

***Adapting to One Market, Helping to Create Another***

It is also important that the enterprise land privatization process to date has released substantial amounts of surplus land into the developing real estate market, even in the absence of a land code or other forms of complete ownership guarantees. Indeed, it could be argued that one of the main benefits of enterprise land privatization has been the liberation of this stock of resources. The infusion of this new class of assets is already contributing to the development of new markets for land and fixed assets – and to the development of the professions, such as appraisal and brokerage services, required to support them. There would appear to be pent-up demand on the part of domestic and foreign firms for land in the St. Petersburg area, and some of this is being met through the sale and leasing of parcels recently purchased from the state by Russian enterprises. Each contemplated or executed land transaction requires the services of professionals ranging from cadastral surveyors and appraisers to brokers and attorneys. Thus, an entire segment of technically-demanding (and usually well-paying) employment opportunities is being created.

In summing up how it felt the significance of the enterprise land privatization effort had evolved, the consulting firm that carried out its most recent USAID-sponsored phase wrote in its final project report (1997) that its team of advisors "succeeded in accomplishing what had become the most important benchmark of all: we created a viable enterprise land market in which land brokers could charge for their services" (p. ii). While this observation alone does not justify a concerted campaign to accelerate enterprise land buy-outs in Russia, it does speak to a potentially significant class of economic benefits that may be a byproduct of – but not always directly benefit – restructuring enterprises themselves.

**Topics for Future Research**

This thesis has served to provide some additional evidence that Russian firms that have bought their land are not behaving precisely as the academic literature, project work plans and textbooks predicted they would. A logical next step for individuals and institutions that care about these issues would be to conduct a more rigorous and comprehensive series of interviews with landowning Russian enterprises. The work of the Leontief Centre and of Howland and Katkhanova produced intriguing survey data, but more open-ended discussions often result in more complete and telling information. The fatalistic shrug of a manager contemplating the security of her land tenure cannot be duplicated in a written questionnaire. To be sure, it is not easy to obtain access to many Russian enterprises; instinctive distrust of outsiders still reigns. But I believe it would be well worth the effort and patience required to forge connections and build trust with these managers so that researchers and practitioners can glean a better sense of the incentives and limitations that help shape their actions.

Another facet of this story that deserves more attention is the body of profile restrictions and dissolution regulations that face struggling enterprises as they consider restructuring or exiting. While I maintain that it is reasonable for some barely viable companies to hang on through land sales and leasing when they might otherwise dissolve themselves, it is possible that some firms are staying alive merely for the sake of staying alive. Based on my own attempts to investigate this issue, it appears that the restructuring literature would benefit from a close examination of the extent to which regulations pertaining to changes in business operations and exit from markets provide disincentives for struggling or failing enterprises to legally revamp their operations or shut down.

Likewise, the questions of efficient and equitable property taxation and land leasing policies that arise in this study merit thorough analysis. Taxation within a post-socialist context is a field of its own, and it was clearly not within the parameters of this paper to explore the many economic and political issues that comprise it. It does seem, however, that there is a need for additional research into the role of tax policy in influencing the ways in which enterprises handle their land. Related to taxation in the sketches I presented was the issue of lease rates which, unlike tax rates, are set by local governments. It would be fruitful to closely examine how these lease rates are established, and whether in doing so local authorities support or undermine the policy aims of the federal officials who set tax rates. A complementary piece of research might be a comparison of Russian enterprises that have bought the land they occupy and which continue to lease it, holding other significant factors constant. Such an analysis could provide important clues about the extent to which there are economic advantages for enterprises to owning land.

Finally, some comparative studies on the sequencing and coordination of land market reforms – including tenure guarantees, cadastre/title registration systems, the property tax, and mortgage financing mechanisms – would be valuable. A popular conclusion among both the Russian and Western experts with whom I talked during the course of my research is that it is virtually impossible to implement one reform without having the others in place beforehand or implementing them simultaneously. A commonly-cited example is that, without a reliable mortgage market infrastructure in place, firms and individuals cannot use their land as collateral for bank loans – and this fact stunts the growth of real estate markets because potential landowners do not foresee one of the biggest benefits typically associated with land tenure. Some of the research presented in this paper suggests that such scenarios do not always unfold; there is evidence that some markets develop regardless of institutional imperfections, and seem to gather self-sustaining momentum even in the face of significant uncertainty. Just how common is this, and what does it say about the "optimal" design of market reforms? These are daunting questions, but questions that I believe are worth pursuing.

# PUBLISHED SOURCES


Alfandari, Gilles and Une Lee. 1995. "Are Enterprises Restructuring?" *World Bank Conference Paper.* Washington, DC.

Bertaud, Alain and Bertrand Renaud. 1994. "Cities Without Land Markets: Lessons of the Failed Socialist Experiment." *World Bank Discussion Papers,* No. 227. Washington, DC.

Boycko, Maxim; Andrei Shleifer; and Robert Vishny. 1997. *Privatizing Russia.* Cambridge, MA: MIT Press.

Brooks, Karen; Elmira Krylatykh; Zvi Lerman; Aleksandr Petrikov; and Vasilii Uzun. 1996. "Agricultural Reform in Russia: A View from the Farm Level." *World Bank Discussion Papers,* No. 327. Washington, DC.

Brzeski, Jan and William Valletta. 1997. "The Role of the Urban Real Property Market in the Transforming Economy of the Russian Federation." *USAID Working Paper.* Washington, DC: U.S. Agency for International Development.

*Business Petersburg.* "Productive Premises: Today It Is Profitable to Buy, Then Lease Out." January 27, 1999.

Chemonics International, Inc. 1997. "Final Report: Roll-Out of the Enterprise Land Sales Program." Washington, DC: U.S. Agency for International Development.

Djankov, Simeon and Gerhard Pohl. 1997. "The Restructuring of Large Firms in Slovakia." Washington, DC: The World Bank, mimeo.

Hart, Oliver and John Moore. 1985. "Incomplete Contracts and Renegotiation." *MIT Department of Economics Working Papers,* No. 367. Cambridge, MA.

Howland, Marie and Anna Katkhanova. 1998. "Post Land Privatization and Change in the St. Petersburg, Russia Industrial Belt." College Park, MD: University of Maryland, mimeo.

Kaganova, Olga; Sheila O'Leary; and Aleksandr Vysokovsky. 1997. "Urban Real Estate Reform Indicators in Transition Countries." Washington, DC: The Urban Institute.

Kaser, Michael. 1995. "Privatization in the CIS." In *Challenges for Russian Economic Reform,* edited by Alan Smith. Washington, DC: The Brookings Institution.

Limonov, Leonid. 1995. "Privatization of Urban Land in Russia: Legislation, Institutions, and Practice." In *Land Policy of Market and Transition Economies: A Comparative Perspective*. St. Petersburg, Russia: Leontief Centre for Social and Economic Research.

Pohl, Gerard; Robert Anderson, Stijn Claessens; and Simeon Djankov. 1997. "Privatization and Restructuring in Central and Eastern Europe." *World Bank Technical Papers,* No. 368. Washington, DC.

Price Waterhouse/PADCO, Inc. 1995. *A Guide to Enterprise Land Sales in Russia*. Washington, DC: U.S. Agency for International Development.

Sachs, Jeffrey. 1993. *Poland's Jump to the Market Economy.* Cambridge, MA: The MIT Press.

Stark, David. 1994. "Recombinant Property in East European Capitalism." *American Journal of Sociology,* 1.

Tideman, Nicolaus and 29 co-authors. 1990. "Open Letter to President Mikhail Gorbachev Regarding the Collection of Land Rents."

United Nations Commission on Trade and Development. 1998. "Enterprise Reform and Privatization." UNCTAD web site.

# INTERVIEWS AND CONSULTATIONS

Belov, Alexei. Deputy Director, Property Foundation, Kirovsky Zavod. February 1999.

Burakov, Valeri. Deputy General Director, DSK-4. February 1999.

Dadykina, Galina. Chief Property Foundation Expert on Land and Real Estate Usage, Kirovsky Zavod. February 1999.

Dixon, Steven. Former Consultant for the Enterprise Land Sales in Russia project, PADCO, Inc. January 1999.

Henward, Howard. Vice President, PADCO Real Estate Advisors, St. Petersburg. January and February, 1999.

Katkhanova, Anna. Senior Researcher, Leontief Centre for Social and Economic Research. January, February, and March, 1999.

Korsun, Georges. Europe/NIS Privatization and Financial Sector Restructuring Group Manager, Chemonics, Inc. January 1999.

Limonov, Leonid. Director, Leontief Centre for Social and Economic Research. January 1999.

Miagkov, Vladislav. Project Manager, PADCO Real Estate Advisors, St. Petersburg. January and February, 1999.

Patterson, Larry. Former Senior Legal Consultant for the Enterprise Land Sales in Russia project, PADCO, Inc. November 1998.

Savulkin, Lev. Senior Researcher, Leontief Centre for Social and Economic Research. January and February, 1999.

Valletta, William. Senior Legal Consultant, Booz-Allen and Hamilton, Inc. December 1998 and February, 1999.

Vlasova, Tatyana. Deputy Director, Leontief Centre for Social and Economic Research. January 1999.

Zvereva, Marina. Director, Real Estate Department, LOMO. February 1999.